AFFILIATE TRANSACTIONS PRICING GUIDELINE

FOR TRANSACTIONS BETWEEN

VERIZON INCUMBENT LOCAL EXCHANGE CARRIERS

AND

VERIZON NON-REGULATED AFFILIATES

Issued January 2002

Contents

OVERVIEW

The Verizon Affiliate Transaction Policy provides guidance in determining permissible transactions between the Verizon ILECs and their non-regulated affiliates and sets forth the FCC and State pricing requirements for these transactions. The Affiliate Transaction Pricing Guideline also provides direction on determining the applicable transaction price and identifies responsibility ensuring requirements are met.

FCC and State Pricing Requirements

The rules that govern the accounting for affiliate transactions involving an ILEC are outlined in the Affiliate Transaction Policy (ATP) located on the Verizon intranet site http://baimsa.verizon.com/corporate/regcompl/atp/index.shtml

For states which follow pricing rules different from the FCC pricing rules, refer to the ATP for regulatory state reporting requirements.

SECTION I

I. A. Pricing of products or services provided by the ILEC to a non-regulated affiliate[1]

1. **The organization responsible for providing the service (Service Provider) applies the FCC pricing hierarchy, as detailed in the ATP, to determine the pricing category for the transaction.**

2. **Based on the pricing category determined in the previous step, the Service Provider follows the noted steps under the applicable pricing category.**

A. Tariff
When a product or service is currently offered pursuant to a tariff, the non-regulated affiliate receives the service at the same tariff rate. Non-tariff services provided pursuant to publicly-filed agreements (interconnection agreements) are provided to the non-regulated affiliate using the rates appearing in such publicly-filed agreements.

<u>Identify and obtain tariff pages</u>

- Products or services pursuant to a tariff provided to Section 272 and Advanced Services Affiliates require the Service Provider to obtain a copy of applicable tariff pages for inclusion in the Officer Certification Package and Public Disclosure.
- Products or services provided to a non-regulated affiliate pursuant to publicly- filed agreements are priced through the same method as non-affiliate arrangements.

B. Prevailing Market Price (PMP)
If no tariff or publicly filed agreement exists for product or service being provided to a non-regulated affiliate, the product or service offering must be assessed to determine if it meets the PMP criteria as outlined in Section II, the following steps must be followed:

<u>Obtain supporting documentation</u>

- The Service Provider must obtain copies of supporting documentation (e.g., sales reports) to substantiate transaction qualifies for PMP.
- For 272/ASA transactions, the Service Provider includes copies of supporting documentation as part of the Officer Certification Package.

[1] In the case of Real Estate transactions, the Real Estate Department and Affiliate Billing are responsible for pricing all activities.

SECTION I. A. (continued)

- The Service Provider must maintain copies of PMP support for audit and regulatory purposes.

C. Higher of Fully Distributed Cost (FDC) or Fair Market Value (FMV)
When a product or service offering does not meet the pricing criteria for tariff or prevailing market price, a comparison of fully distributed cost to fair market value must be completed to determine the transaction price.

Calculate Fully Distributed Cost (see Section III)
- The Service Provider must determine the pricing assumptions associated with the service to be provided, including identification of direct and indirect cost.
- In accordance with Affiliate Billing CAI 103 located on the Verizon intranet site http://baimsa.bellatlantic.com/corporate/fincomp/cb/fun/abhtml/html/abpolicy.htm, the Service Provider must contact Affiliate Billing to obtain calculation of FDC. Generally, Affiliate Billing will use actual cost to calculate FDC. However, depending on the nature and complexity of the transaction, it may be necessary for Affiliate Billing to engage the Service Cost Department to calculate FDC.
- Affiliate Billing retains the FDC supporting documentation for audit and regulatory purposes. The definition of **supporting documentation** as it relates to this Pricing Guideline refers to primary workpapers that develop the calculation of the amount to be billed, including references to the source documents supporting the calculation. Source documents include, but are not limited to:
    - Account balances in a company's general ledger, internal or annual report
    - Annual loading rate study
    - Accounts payable file with specific voucher reference, if applicable
    - Payroll file with specific reference to an employee, if applicable
    - Supporting workpapers that develop the calculation of percent of non labor expenses to labor expenses
    - Subject Matter Expert advice or opinion

Obtain Fair Market Value (see Section IV)
- The Service Provider must obtain Fair Market Value and provide the supporting documentation to Affiliate Billing for billing comparison.
- Affiliate Billing retains FMV supporting documentation for audit and regulatory purposes.

Compare Fully Distributed Cost to Fair Market Value (see Section V)
- Affiliate Billing compares results of the Fully Distributed Cost calculation to the FMV, using the higher result as the transaction price.
- For 272/ASA transactions, the Service Provider includes copies of supporting documentation as part of Officer Certification Package.

I. B. Pricing of products or services provided from a non-regulated affiliate to the ILEC

1. The business entity providing the service (Service Provider) must contact their business unit attorney and forward a written notification of the proposed transaction to the Affiliate Interest Compliance Office ("AICO").

2. The Service Provider applies the FCC pricing hierarchy to determine the pricing category for the product or service offering as follows:

A. Tariff
When a product or service is currently offered by a non-regulated affiliate pursuant to a tariff, the ILEC receives the service at the same tariff rate.

<u>Identify and obtain tariff pages</u>

- Products or services pursuant to a tariff provided by Section 272 and Advanced Services Affiliates require the Service Provider to obtain a copy of applicable tariff pages and include them as part of the Officer Certification Package and Public Disclosure.

B. Prevailing Market Price
When a product or service offering is assessed to determine if it meets the (PMP) criteria as outlined in Section II, the following steps must be followed:

<u>Obtain supporting documentation</u>

- The Service Provider must obtain copies of supporting documentation (e.g., sales reports) and review documentation with AICO.
- AICO will provide sign-off to the Service Provider as to whether or not the transaction meets PMP requirements.
- The Service Provider maintains copies of PMP support for audit and regulatory purposes.

C. Lower of Fully Distributed Cost or Fair Market Value
When a product or service offering does not meet the pricing criteria for tariff or prevailing market price, a comparison of fully distributed cost to fair market value must be completed to determine the transaction price.

<u>Calculate Fully Distributed Cost</u> (see Section III)

- The Service Provider must determine the pricing assumptions associated with the service to be provided, including identification of direct and indirect cost.
- The Service Provider engages their accounting organization to assist in the development and application of the appropriate indirect costs and loadings. The Service Provider is responsible for the completeness and accuracy of the FDC calculation. The Service Provider retains the FDC calculation and supporting documentation for audit and regulatory purposes.

<u>Obtain Fair Market Value</u> (see Section IV)

- The Service Provider must obtain Fair Market Value and review the supporting documentation with AICO for concurrence that good faith effort requirement has been met.
- The Service Provider maintains FMV supporting documentation for audit and regulatory purposes.

<u>Compare Fully Distributed Cost to Fair Market Value</u> (see Section V)

- The Service Provider will compare results of the Fully Distributed Cost calculation to the Fair Market Value, using the lower result as the transaction price.
- For 272/ASA transactions, Service Provider includes copies of supporting documentation as part of Officer Certification Package.

I. C. Pricing of products or services provided from a Service Company to the ILEC

Service Company transactions are priced at fully distributed cost under FCC requirements. Affiliate Billing and Corporate Reporting oversee the allocation of Service Company costs.

I. D. Pricing the sale of assets between the ILEC and a non-regulated affiliate

1. The Service Provider must engage Asset Accounting to initiate the transaction pricing process.

- Asset Accounting calculates Net Book Value
- Asset Accounting obtains Fair Market Value
- Asset Accounting makes FCC 96-150 pricing assessment
- The Service Provider must provide transaction support as part of Officer Certification Package for 272/ASA transactions.
- Asset Accounting retains transaction support for audit and regulatory purposes.

2. **On an annual basis Asset Accounting will provide AICO a transaction report of asset transfers between the ILEC and all non-regulated affiliates .**

SECTION II

Prevailing Market Price (PMP)

FCC requirements
For a transaction to qualify for PMP valuation, more than 50 percent (25% effective 2002) of a particular product or service must be provided to third parties. The 50 percent (25% effective 2002) threshold is on a product-by-product or service-by-service basis, rather than on a product line or service line basis.

> Exception transactions with 272 and Advanced Services Affiliates: In the case of transactions for services subject to section 272 (of the Telecommunications Act of 1996), a BOC may record such transactions at PMP regardless of whether the 50 percent (25% effective 2002) threshold has been satisfied. This exception may also apply to transactions between ILECs and Advanced Services Affiliates. Legal or AICO must be consulted before applying this exception.

Frequency
Validation of PMP must occur at least on a biennial basis, or when a new contract arrangement has been entered into with an affiliate or when a significant change occurs relative to the quantity of a product or service sold.

Methodology
As stated in Section I, it is the responsibility of the Service Provider to obtain the supporting documentation documenting the transaction is eligible to qualify for PMP.

> Examples of supporting documentation reflecting more than 50 percent (25% effective 2002) of a particular product or service is provided to third parties include but are not limited to, the following:
> - Sales Reports
> - Invoices
> - Standard Contracts
> - Revenue Reports in cases where prices are universal

Products or Services provided from the ILEC to a non-regulated affiliate
The Service Provider must provide the appropriate documentation to Affiliate Billing for billing purposes.

Products or Services provided from a non-regulated affiliate to the ILEC
The Service Provider must review supporting documentation with AICO for concurrence the transaction is eligible to qualify for PMP.

SECTION III

Development of Fully Distributed Cost (FDC)

FCC Requirements
Cost allocation standards are set forth in Part 32 and Part 64 of the FCC rules which require the use of the attributable cost method of cost allocation, and compliance with the FCC requirements for affiliates' rate base development. Development of fully distributed cost requires the identification of direct and indirect costs, common overhead and a return on investment. FCC 96-150 currently permits an 11.25% rate of return. However, in the event a jurisdictional commission wishes to impose their singular judgement on the ROI, refer to the State Affiliate Pricing Requirements in the Affiliate Transaction Policy located http://baimsa.verizon.com/corporate/regcompl/atp/index.shtml.

For further financial reference in conjunction with the FDC calculation, please refer to APM3 located on the Affiliate Billing intranet site
http://baimsa.bellatlantic.com/corporate/fincomp/cb/fun/abhtml/html/abpolicy.htm

Frequency
The FDC calculation is to be performed whenever a new contract arrangement has been entered into with a non-regulated affiliate. The FDC calculations on existing arrangements should be reviewed annually, or when any material change to the ILEC's/non-regulated affiliate's cost structure has occurred.

SECTION IV

Obtaining Fair Market Value (FMV)

FCC requirements
The FCC requires a good faith effort at determining fair market value for each service when the total annual value of the service reaches or exceeds $500,000 on a legal entity basis. The baseline for a good faith determination of fair market value requires the use of methods that are routinely used by the general business community.

Methodology
As stated in Section I, it is the responsibility of the Service Provider to obtain the FMV for the service to be provided. The AE or RE may engage Corporate Sourcing (212) 338-1086 to assist in obtaining FMV through means available in the public domain or by engaging an independent party. If it is determined to engage an independent party to perform a market study, the associated fee charged to Verizon is paid by the Service Provider.

Sources for determining FMV include, but are not limited to, the following:

- Catalog listings
- Public information on the Internet (e.g., **salary.com** for wage information)
- Competitive bids
- Industry publications
- Company/Departmental benchmarking studies
- Significant sales to third parties
- Appraisals
- Replacement cost of an asset

All documentation supporting FMV must be retained by the Service Provider. Affiliate Billing should retain the appropriate supporting documentation needed for audit purposes.

Frequency
A review and update if deemed necessary of the FMV study should be conducted at no more than three year intervals, when a new contract arrangement has been entered into with an affiliate, or when any material change to the ILEC's or non-regulated affiliate's cost structure has occurred. **Note: When FMV studies are reviewed and updated on three year intervals, transactions with Verizon California require a Consumer Price Index (CPI)[2] adjustment to be added to the FMV amount in the interim years. This adjusted FMV must then be compared to FDC to determine the appropriate transaction price. When FMV studies are reviewed and updated more frequently than every three years, no CPI adjustment to the FMV amount is required for determining the pricing for transactions with Verizon California.**

[2] The rate for CPI – For All Urban Consumers should be used in the annual adjustment. This rate is published by U.S. Department of Labor's Bureau of Labor Statistics in its Monthly Review.

SECTION V

FDC to FMV Comparison

Products or Services provided from the ILEC to a non-regulated affiliate
Upon completion of the development of FDC and obtaining FMV, the Service Provider must provide all pricing documentation to Affiliate Billing for determining the transaction price for billing.

Products or Services provided from a non-regulated affiliate to the ILEC
Upon completion of the development of FDC and obtaining FMV, the Service Provider must review all documentation with AICO for concurrence the resulting transaction price meets the FCC guidelines.

NOTE: In ALL instances where FMV cannot be obtained, the Service Provider must contact their business unit attorney and AICO PRIOR to any service or billing taking place to validate support documentation is maintained for audit and regulatory purposes.